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No. 82-106

IN THE

Supreme Court of the United States

October Term, 1982

GLEN CORPORATION, *et al.*,
Petitioners,

against

O.C. ASSOCIATES, *et al.*,
Respondents.

BRIEF FOR RESPONDENT O.C. ASSOCIATES IN OPPOSITION

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Question Presented

Is a reorganization plan "fair and equitable" if it permits stockholders of the debtor to receive substantial payments while creditors are to receive less than full compensation for the debtor's use of their money?

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Petitioners,

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O.C. ASSOCIATES, *et al.*,

Respondents.

BRIEF FOR RESPONDENT O.C. ASSOCIATES IN OPPOSITION

This brief is submitted on behalf of respondent O.C. Associates[1] in opposition to a petition by Glen Corporation, Monte J. Wallace, Neil W. Wallace and the Minority Stockholders Committee of Continental Investment Corp. ("CIC") (the "petitioners")[2] for a writ of certiorari to review a judgment and opinion of the United States Court of Appeals for the First Circuit[3] entered in this case on

1. O.C. Associates is a partnership whose general partners are affiliates of Oppenheimer & Co. and the Charter Company.

2. The Wallaces were the founders and principal officers of CIC, and controlled in excess of 60 percent of the stock of CIC.

3. *See* Appendix A. All references to "Appendix" refer to the appendices annexed to the petition for writ of certiorari (the "Petition"); specific pages within the Appendix will be designated by a number followed by the letter "a". The First Circuit's decision reversed the decision of the United States District Court for the District of Massachusetts. *See* Appendix B.

April 30, 1982.[4] The First Circuit held that the reorganization plan for CIC violated the "fair and equitable" rule of Chapter X of the Bankruptcy Act because it failed to give creditors of CIC (including this respondent) full compensation for their claims, while providing for distributions of about $40 million to stockholders of CIC. Specifically, the First Circuit held that where the debtor is solvent, to satisfy the fair and equitable rule, a rule of "absolute priority" in Chapter X cases, the reorganization plan must compensate holders of CIC debentures for the debtor's use of their money, including both principal and unpaid installments of interest, during the five years that the reorganization case was pending.

Statement of the Case

The decision below raises no question warranting review by this Court because it followed two well-settled rules of bankruptcy law: first, the entitlement to post-petition interest on valid claims is a matter of federal, not state law; and, second, when the debtor is solvent, under Chapter X of the Bankruptcy Act[5] creditors are entitled to

4. This action, entitled *O.C. Associates* v. *Continental Investment Corp.*, No. 81-1743, was consolidated with three other cases in the court of appeals: *Debentureholders Protective Comm. of Continental Investment Corp.* v. *Continental Investment Corp.*, No. 81-1741; *Bankers Trust Co., Indenture Trustee* v. *Continental Investment Corp.*, No. 81-1756; and *First National Bank of Boston, Indenture Trustee* v. *Continental Investment Corp.*, No. 81-1742. The Petition herein seeks review of the decision in the first three of these cases, but not the fourth.

5. Former 11 U.S.C. §§ 101 *et seq.* On November 6, 1978, Congress enacted the Bankruptcy Reform Act of 1978, replacing the Bankruptcy Act (the "Act") with the new Bankruptcy Code (the "Code"), 11 U.S.C. §§ 101 *et seq.* The Act, not the new Code, is applicable to this case. *See* Bankruptcy Reform Act of 1978, tit. IV, § 403(a), 92 Stat. 2683.

receive, under the Act's "fair and equitable" rule, full compensation for all of their claims, including post-petition interest on claims for accrued interest, before the stockholders of the debtor may receive anything. In following those black letter rules the court of appeals rendered a very narrow decision which creates no conflict, wreaks no havoc, and does not, as the Petition suggests, create a "new federalism" under which the rights of the states will be trampled underfoot.

Furthermore, the points raised in the Petition are rendered largely academic by the enactment of the Bankruptcy Code, which superseded the Bankruptcy Act on October 1, 1979, because the Code explicitly requires solvent debtors to pay post-petition interest on *all* creditor claims. Thus, any dispute on this point which might arise under the old Bankruptcy Act is essentially of historical interest only.

Facts

At the time CIC filed its voluntary petition under the Bankruptcy Act on April 30, 1976, it had already defaulted on payments of over $6 million in interest due to its debentureholders, respondents herein. CIC had the use of that money for over 5 years, while the reorganization case was pending. During those five years approximately $17 million in additional interest installments became due, but were once again not paid. CIC also had the use of this $17 million while its reorganization case was pending. The district court found the estate of CIC to be solvent, and it is not disputed that there is enough money to pay interest to the debentureholders to compensate them for this extended use of their funds.

If interest is denied, CIC and its stockholders (*i.e.*, petitioners)—who received $40 million at the conclusion of the reorganization case—will have received a windfall of over $6 million, which represents the interest which the debentureholders could have earned on this money during the period while this case was pending (conservatively calculated at the "legal" 8 percent rate of interest). The First Circuit properly ruled that it would not be fair and equitable to give CIC's stockholders such a windfall, at the debentureholders' expense. That is the ruling which petitioners ask this Court to review.

Background

In 1973, CIC issued 9% subordinated debentures in the aggregate principal amount of $37,158,900 (the "debentures").[6] Principal on the debentures was due in 1985; interest was payable in semi-annual installments. The indenture under which the debentures were issued provides that New York law governs the construction and enforceability of the debentures. In November 1974, CIC stopped paying interest due under the debentures and made no further payments up to April 30, 1976, when it filed its petition in the District Court for the District of Massachusetts.[7]

On May 24, 1976, a proof of claim was filed for all holders of the debentures, in the total amount of $43,838,212.28, consisting of $37,158,000 in principal, plus interest,

6. CIC had previously issued $30,000,000 in convertible debentures. The First Circuit's decision granting post-petition interest to those debentureholders is not challenged in the Petition.

7. CIC's petition originally sought an arrangement under Chapter XI of the Bankruptcy Act; the case was later converted to a Chapter X case.

of which $6,679,312.28 was due and payable as of April 30, 1976. The claims of the debentureholders were allowed by the court and are not challenged in the Petition. All that is at issue is the proper amount of post-petition interest which should be awarded on those claims.

The Trustee's Third Modified Plan of Reorganization for CIC (the "Plan") included a stock purchase agreement between Liberty National Insurance Holding Co. ("Liberty") and the Trustee, which provided for the purchase by Liberty of all the issued and outstanding common stock of CIC for $166 million. In its order confirming the Plan, the district court found that the reorganization value of CIC was $166 million, and that, because the claims against the CIC estate were substantially less than that amount, "CIC is therefore solvent." It is undisputed that sufficient funds exist to pay the claims of all creditors, in full, including all claimed post-petition interest thereon.

The Plan provided that the "allowed claims" of all creditors were to be satisfied in full in cash. The Plan further provided that creditors were to receive post-petition interest on their claims. Where those claims did not arise out of an instrument or agreement with a specified rate of interest, the creditors were to receive post-petition interest on their claims computed at the legal rate of 8 percent per year.[8] However, the debentureholders were to receive post-petition interest only on their claims for the principal amount of the debentures; they were denied *any* post-petition interest on the portion of their allowed claims

8. Thus, in the Plan, the Trustee recognized the right of creditors to receive post-petition interest on their claims in the context of a solvent debtor's estate, even in the absence of an agreement providing for such interest. This is the very principle of bankruptcy law confirmed by the First Circuit in the decision below.

which consisted of unpaid installments of interest. After the satisfaction of allowed claims of all creditors, CIC's stockholders were to receive the balance of the $166 million received from Liberty National, which was about $40 million.[9]

The Decisions Below

In its Memorandum and Order dated September 9, 1981, the district court rejected the debentureholders' claims for post-petition interest on that portion of their allowed claims represented by unpaid installments of interest. The district court decided that state law "must govern the determination of whether the debentureholders' claim to interest is enforceable and should be enforced" (19a). On the basis of its construction of governing New York law the district court decided that the debentureholders "have no valid claim to the additional interest that [the court] may choose to enforce against the debtor" (21a). In support of its decision the district court also noted that the principal amount of each subordinated debenture would be paid four years in advance of the 1985 maturity date (22a-23a).[10]

9. Prior to approval of the Plan, representatives of the convertible and subordinated debentureholders asserted their rights to post-petition interest (through the date of payment) on their *entire* allowed claims. The issue of the debentureholders' entitlement to post-petition interest was deferred until after the district court's approval of the Plan. The debentureholders and other creditors were not afforded the opportunity to vote to accept or reject the Plan because the court determined that their rights were not being affected thereby, inasmuch as they would be entitled to receive payment in the full amount of their claims.

10. With respect to the convertible debentures, the district court found that while applicable Massachusetts law permitted agreements to pay such interest, payment of the full amount of principal due the debentureholders nine years before the final maturity date satisfied the requirement that the plan be fair and equitable.

(footnote continued on next page)

On appeal, the First Circuit rejected, in total, the reasons offered by the district court for denying post-petition interest to both classes of debentureholders. The court of appeals determined that while state law determines what *pre-petition* interest is allowable, federal law—not state law—determines whether *post-petition* interest on an allowable claim is to be paid by a solvent debtor's estate (15a). In accordance with the "fair and equitable" rule of the Bankruptcy Act, the court of appeals determined that the debentureholders were entitled to full compensation, including post-petition interest, on *all* components of their claims,[11] including unpaid pre-petition and post-petition installments of interest.[12] In so holding, the First Circuit confirmed the long-standing principle of bankruptcy law that if a debtor's estate is solvent, creditors have a right to be fully compensated on all elements of their claims before any payment is made to stockholders (*i.e.*, the petitioners).

In ruling that accelerated payment of the principal, as provided in the Plan, would compensate all debentureholders for the debtor's use of all of their funds, the district court apparently ignored the fact that the debentureholders were entitled to accelerate payment of the principal amount of their debentures as early as 1974, when CIC initially defaulted. Had the CIC reorganization proceedings not intervened, the debentureholders could then have obtained a judgment on their outstanding principal and accrued interest claims, and received interest on that *entire* judgment at the prevailing legal rate.

11. In the absence of a provision fixing a valid contractual rate of interest to be allowed on a claim, the First Circuit determined that the appropriate measure for the claimants' loss of the use of their funds during the pendency of a bankruptcy case is the "legal" or "judgment" rate of interest, 8 percent. That is the rate of interest accorded to the claims of other unsecured creditors whose claims had no agreed-upon rate of interest.

12. The First Circuit also rejected the district court's conclusion that payment of the principal of the debentures in advance of the due date might function as surrogate compensation in lieu of post-petition interest. The court noted that upon CIC's default in paying interest the debentureholders became entitled to accelerate payment of the principal. Thus, the payout of principal of the debentures gave the debentureholders no right which they did not already have.

NO REASON EXISTS FOR THE ISSUANCE OF A WRIT OF CERTIORARI

I.

THE COURT OF APPEALS FOLLOWED THE WELL-SETTLED RULE THAT FEDERAL BANKRUPTCY LAW, NOT STATE LAW, DETERMINES WHETHER POST-PETITION INTEREST IS TO BE AWARDED.

The entire premise of the Petition is that state law, not federal bankruptcy law, determines whether creditors are entitled to post-petition interest on their claims. That premise is wrong: under the Bankruptcy Act, state law has nothing to do with this question.[13]

This Court held in *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156, 161, 163 (1946), *reh. denied*, 329 U.S. 833 (1947), that while state law determines whether or not there is a valid pre-petition claim against the debtor which may be allowed in a bankruptcy case, *federal* law determines whether post-petition interest will be allowed on that claim:

> What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law.
>
> • • •
>
> *When and under what circumstances federal courts will allow interest on claims against debtors' estates*

13. As discussed in Point III, *infra*, the new Bankruptcy Code reaffirms this principle by expressly stating that post-petition interest is to be paid on *all* allowed creditors' claims, if funds are available to do so.

> ***being administered by them has long been decided by federal law.*** (emphasis added).[14]

This Court *expressly rejected* the reasoning of the Sixth Circuit in that case below, which, like petitioners in this case, thought that the recoverability of post-petition interest was a question of state law;[15] and it also did not accept the analysis of Justice Frankfurter's concurrence, cited frequently by petitioners here, to the same effect.

Petitioners—not the court of appeals below—seek to tamper with this rule by arguing, in the teeth of the clear language of *Vanston*, that state law, not federal law, controls on the question of whether post-petition interest may be allowed. *No* decision of this Court has superseded

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14. This principle was recently reiterated in *In re Marx*, CCH Bankr. Rep. ¶ 68,250, pp. 79,435, 79,437 (S.D. Ohio 1981):

> The subject of the allowance of post-petition interest is, in the final analysis, governed by the equitable principles of bankruptcy administration rather than the validity of such an interest claim under state law. The necessary and inherent power of a bankruptcy court to determine how a debtor's assets shall be distributed is paramount on the subject of post-petition interest.

The principle that "the manner in which the rights of debtors and creditors are adjusted [is a] matter of federal law" was recently reaffirmed by this Court in *Northern Pipeline Construction Co.* v. *Marathon Pipeline Co.*, 50 U.S.L.W. 4892, 4901 n.36 (U.S. June 28, 1982).

15. This Court stated:

> The Circuit Court of Appeals thought the bankruptcy court must allow or disallow the claim for [post-petition] interest on interest according to whether the covenant to pay it was valid or invalid [under state law]. . . .
>
> We agree with the conclusion of the Circuit Court of Appeals that the claim for interest on interest should not be permitted to share in the debtor's assets, *but disagree with the reasons given for that conclusion.*

Id. at 160-61 (emphasis added). In fact the Sixth Circuit had denied interest on interest for the same reason advanced by petitioners here: the fact that New York (and other) state laws did not permit it. The Court held that state law is irrelevant.

Vanston by holding that post-petition interest may not be granted by a bankruptcy court because state law does not permit it. This Court should not grant certiorari in order to entertain petitioners' attempt to overturn *Vanston* and replace in its stead a two-step test under which post-petition interest *must* always be denied where state law would invalidate an agreement between the parties to pay such interest.

Petitioners claim to find an inconsistency between the decision below and the decision of this Court in a pre-*Vanston* case, *Ecker* v. *Western Pacific Railroad Corp.*, 318 U.S. 448 (1943) (Pet. at 11). But *Ecker* contains no discussion whatsoever of whether federal or state law determines the availability of post-petition interest. Petitioners do not even point to any discussion or holding by the Court in that case; rather, they appear to rely solely upon a chart set out at page 445 of that opinion, which indicates that the plan of reorganization provided for (both pre- and post-petition) interest at the contract rate for a series of creditors. One senior creditor (R.F.C.) had advanced $10,000,000 to the debtor *after* the petition in bankruptcy had been filed (*id.* at 485), and had received in exchange a *non-interest-bearing* Trustee's certificate. In other words, R.F.C. had agreed to ask for no post-petition interest (in exchange for which its loan received priority over all other debts of the debtor). The fact that the plan of reorganization awarded no post-petition interest to R.F.C. under such circumstances indicates only an adherence to the parties' agreement that there would be no such interest—and not any *inability* of the court to award interest in other circumstances.

Petitioners' discussion of *Ecker* reflects their confusion of the *right* to interest with the *rate* of interest. In *Ecker*, as in other cases,[16] the courts, having determined that there is a *right* to interest, have taken the applicable *rate* from the parties' agreement. But it does not follow that, in the absence of an enforceable agreement setting such a *rate*, there is therefore no *right* to interest at all. Rather, in such cases courts have awarded interest at the applicable "legal" rate. *See In re Lum*, 1 B.R. 186, 188 (E.D. Tenn. 1979); *In re Imperial "400" National, Inc., supra*, 374 F. Supp. at 954. That is precisely what the district court did in this case for the benefit of CIC's other creditors whose claims bore no contractual rate of interest.[17]

Petitioners also assert that the decision below is inconsistent with cases in which the courts have allegedly looked to state law in deciding whether and how much post-petition interest is to be paid to creditors whose collateral is sufficient to cover both the claim and post-petition interest (Pet. at 10-11 and n. 12). No such inconsistency exists, because petitioners' cases do not stand for that proposition. For example, in *Coder* v. *Arts*, 213 U.S. 223, 245 (1909), after deciding that the mortgage in question was not a voidable preference under the Bankruptcy Act, this Court, in its *only* reference to the question of recoverability of interest on the claim, made no reference at all to state law:

> Nor do we think the Circuit Court of Appeals erred in holding that inasmuch as the estate was ample for that

16. *See, e.g., Ruskin* v. *Griffiths*, 269 F.2d 827, 830-832 (2d Cir. 1959), *cert. denied*, 361 U.S. 947 (1960); *In re Maryvale Community Hospital*, 156 F.2d 410, 413 (9th Cir.), *cert. denied*, 409 U.S. 879 (1972); and *In re Imperial "400" National, Inc.*, 374 F. Supp. 949, 954 (D.N.J. 1974).

17. And that is what section 726(a)(5) of the new Bankruptcy Code does.

purpose, Arts was entitled to interest on his mortgage debt.[18]

Ticonic National Bank v. *Sprague*, 303 U.S. 406 (1938), also cited by petitioners for the proposition that this Court felt bound by state law, in fact flatly contradicts that theory. In *Ticonic* this Court granted certiorari to resolve a conflict among the circuits on the question of whether secured creditors of a debtor bank were entitled to post-petition interest on their claims. The rule set down by *Ticonic* was a uniform one: secured creditors *are* entitled to such interest where their security is sufficient to cover it. *Id.* at 413. No uniform rule would have been possible if this Court had concluded that the issue was governed by state law.

The decision below is also not inconsistent with other decisions interpreting the right to enforce usurious loans in bankruptcy court, and, in particular, with *Speare* v. *Consolidated Assets Corp.*, 367 F.2d 208 (2d Cir. 1966) (Pet. at 11). There is nothing in *Speare* to indicate that the creditor was seeking post-petition interest at all. Rather, *Speare* deals with the question of whether the lender was entitled to *any* interest on a usurious loan (or even to a return of its principal)—a question which, under the first prong of the *Vanston* test (*i.e.*, the determination of whether a claim arises at all), is a question of state law.

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18. Similarly, neither *Palo Alto Mutual Savings & Loan Ass'n* v. *Williams*, 245 F.2d 77, 79 (9th Cir. 1957), nor *Eddy* v. *Prudence Bonds Corp.*, 165 F.2d 157 (2d Cir. 1947), *cert. denied*, 333 U.S. 845 (1948), cited by petitioners, even mentioned, much less relied upon, state law in determining that post-petition interest was allowable.

Finally, petitioners assert that the decision below conflicts with the Second Circuit's decisions in *Empire Trust Co.* v. *Equitable Office Building Corp.*, 167 F.2d 346 (2d Cir. 1948) and *In re Realty Associates Securities Corp.*, 163 F.2d 387 (2d Cir.), *cert. denied*, 332 U.S. 836 (1947). Although neither of those decisions discussed the distinction between pre- and post-petition interest on claims, it appears that the Second Circuit did rely upon state law in refusing to allow post-petition interest on claims for unpaid interest.[19] However, that is not the approach which has subsequently been followed in the Second Circuit. In *Ruskin* v. *Griffiths*, *supra*, 269 F.2d at 830, that court enforced a provision in the claimant's note for an increase in the rate of interest in the event of bankruptcy—a provision which the court assumed was equivalent to an agreement to pay interest on interest. In so doing it relied upon equitable principles of *federal* law, and never once mentioned the question of whether the agreement was valid under state law. Similarly, in *Corbin* v. *Federal Reserve Bank of New York*, 629 F.2d 233, 237-38 (2d Cir. 1980), *cert. denied*, 450 U.S. 970 (1981), a case under the National Bank Act where the creditor sought to enforce a post-insolvency-loan agreement providing for "interest on interest", the court once again ignored state law. In discussing whether the awarding of such interest would be fair under the principles of *Vanston*, the court found *Realty Associates* and *Empire Trust* to be irrelevant:

> None of the Second Circuit cases cited by the Trustee of FNYC extends *Vanston* to this kind of case. In *In*

19. However, in *Realty Associates* the Chapter X reorganization case had been dismissed, so the court was not faced with the question of whether the reorganization plan was "fair and equitable".

> *re Realty Associates Securities Corp.*, the court simply enforced interest provisions of the bond indenture refusing to alter them by substituting a judgment return of interest or compound interest.
>
> • • •
>
> In *Empire Trust* the court merely held that the indenture provisions for the payment of interest on interest were invalid under New York law. (citations omitted).

Thus, the Second Circuit does *not* currently adhere to petitioners' view of the talismanic significance of state law, and the law of the two circuits is therefore not in conflict on this point.

Moreover, even if we assume that *Empire Trust* and *Realty Associates* still have continuing vitality in the Second Circuit, the existence of a conflict with two thirty-year-old decisions of one other circuit court does not warrant the grant of certiorari here. *Empire Trust* and *Realty Associates* were incorrect in ignoring the clear rule of *Vanston* that the right to post-petition interest is governed by federal, not state law. These are half-forgotten decisions (not even cited for this proposition by petitioners in the court below), old curiosities well outside of the mainstream of subsequent opinion even in their own circuit. Certiorari is certainly not needed to reaffirm the teaching of *Vanston* or to reject the reasoning of two isolated, obsolete decisions, especially because (as discussed in Point III), the Bankruptcy Code squarely rejects the holdings of *Empire Trust* and *Realty Associates* and thereby eliminates any possibility of confusion on this point in the future.

II.

THE COURT OF APPEALS ALSO FOLLOWED THE WELL-SETTLED RULE THAT WHERE THE DEBTOR IS SOLVENT THE BANKRUPTCY ACT REQUIRES THE PAYMENT TO CREDITORS OF FULL COMPENSATION, INCLUDING POST-PETITION INTEREST, BEFORE STOCKHOLDERS MAY RECEIVE ANY DISTRIBUTION FROM THE ESTATE.

A. The Rule Is Clear.

In determining whether post-petition interest should be awarded to creditors, the district court must look to the "fair and equitable" test of the Bankruptcy Act—not to state law.[20] Where the debtor is solvent, that test has been consistently construed to require that creditors must receive post-petition interest on *all* allowed claims before stockholders may receive any distributions from the estate.

In *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, *reh. denied*, 308 U.S. 637 (1939), this Court expressly held that a plan of reorganization under Chapter X must meet the strict standards of the "absolute priority" rule set forth in *Northern Pacific Railway* v. *Boyd*, 228 U.S. 482 (1913) in order to satisfy the statutory "fair and equitable" rule. The absolute priority rule requires that senior creditors must be paid *in full* before junior creditors receive anything. *Consolidated Rock Products* v. *DuBois*, 312 U.S. 510 (1941); *SEC* v. *American Trailer Rentals*, 379 U.S. 594

20. Article VII, Section 174 of the Bankruptcy Act, 11 U.S.C. § 574, states that the district court shall approve the plan of reorganization under Chapter X only if it is "fair and equitable"; and Article XI, Section 221, 11 U.S.C. § 621, provides that the judge shall confirm a plan only if it is "fair and equitable".

(1965). The "absolute priority" rule also provides that, when a Chapter X estate is solvent, interest on a claim must receive the same priority in distribution as the underlying claim. As succinctly stated in 6 Collier pt. II, *Bankruptcy* ¶ 9.08 at 1570, 1583 (14th ed. 1978), the absolute priority rule

> demands that creditors of each class receive full compensatory treatment for the entire bundle of rights they surrender. Interest on a claim to the date of payment is one of such rights. Where the plan provides for payment in full, interest to the date of payment would seem essential before anything is turned back to the debtor or its stockholders. To return assets without providing for the payment of such interest would certainly seem to do violence to the "absolute priority" rule.

This language was quoted with approval in *In re Imperial "400" National Inc., supra,* 374 F. Supp. at 953-54. This principle was also recognized in *Vanston,* where the Court stated that

> where an estate was ample to pay all creditors and to pay interest even after the petition was filed, equitable considerations were invoked to permit payment of this additional interest to the secured creditor rather than to the debtor. 329 U.S. at 164 (citations omitted).[21]

In accordance with this principle, there is a general rule that post-petition interest on creditors' claims is to be allowed when the debtor is solvent. *In re Maryvale Com-*

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21. That rule was not applied in *Vanston* itself because the debtor was *insolvent*; therefore, any award of post-petition interest to a senior creditor would have injured junior creditors. In such a case the absolute priority rule was held not to require payment of post-petition interest. But that principle does not apply where the only parties who would be "injured" by an award of post-petition interest would be stockholders. *See Raskin* v. *Griffiths, supra,* 269 F.2d at 831.

munity Hospital, Inc., 456 F.2d 410, 413 (9th Cir.), *cert. denied*, 409 U.S. 879 (1972); *Ruskin* v. *Griffiths*, *supra*, 269 F.2d at 830; *In re Imperial "400" National, Inc.*, *supra*, 374 F. Supp. at 953; *In re International Hydro-Electric System*, 101 F. Supp. 222 (D. Mass. 1951). *See also United States* v. *Bass*, 271 F.2d 129, 130 (9th Cir. 1959); *Mortgage Loan Co.* v. *Livingston*, 78 F.2d 517, 521 (8th Cir.), *cert. denied*, 296 U.S. 607 (1935); and *City of New York* v. *Saper*, 336 U.S. 328, 330 n.7 (1949).[22]

Petitioners have conceded that the debentureholders had a right to payment of post-petition interest on the principal amount of their claim—*i.e.*, to payment of installments of interest on the debentures which fell due after the petition was filed—and the reorganization plan so provided. There is, of course, overwhelming support for the debentureholders' right to such "simple" post-petition interest in a solvent case. *See, e.g., Consolidated Rock Products* v. *DuBois*, *supra*, 312 U.S. at 515 n.4, 529, where Justice Douglas, writing for the Court, stated that under the absolute priority rule, accrued interest on bonds was "entitled to the same priority as the principal", and that any effort to infringe upon such right for the benefit of stockholders "comes within the judicial denunciation". Petitioners nonetheless seek to draw a distinction between post-petition interest on principal, which they concede is allowable, and post-petition interest on the accrued interest, which they claim is not allowable.

No such distinction exists. What petitioners fail to recognize is that bankruptcy courts grant post-petition in-

22. While in some of these cases the creditors had a contractual right to interest (*see* Pet. at 8-12), as noted above, even where there is no agreement for interest the court may award interest at the legal rate.

terest on *claims*, which in this case included claims for unpaid installments of interest. There is no reason for treating the interest portion of a claim any differently from the principal portion of that claim; for, under Chapter X of the Bankruptcy Act, all types of claims, of whatever character, receive equal treatment, including the principal and accrued interest components of a claim.[23] Therefore, *each* component of that claim, including the claim for interest, must be fully compensated in accordance with the fair and equitable rule.[24] Thus, because the CIC estate is solvent, the Court of Appeals followed well-settled rules in holding that all creditors, including the debentureholders, are entitled to receive post-petition interest in compensation for their *entire* claim.

Petitioners contend that the absolute priority rule does not create a right to post-petition interest and that such a right must be predicated upon state law (Pet. at 12-16). For this they place principal reliance upon *Vanston* and *Ecker*, which, as we have demonstrated above, do not support such a proposition. In addition, they rely upon *In re New York, New Haven and Hartford Railroad*, 4 B.R. 758, 799 (D. Conn. 1980) (Pet. at 14), for the proposition that the absolute priority rule does not determinate what interest is

23. Under Section 106(4) of the Bankruptcy Act, claims are defined to include "all claims of whatever character . . . whether secured or unsecured, liquidated or unliquidated, fixed or contingent." As stated in 6 Collier pt. I, *supra*, ¶ 2.05 at 306, this definition is "sweeping in scope", is "a more inclusive definition than that applicable in ordinary bankruptcy, and it should be given a broad construction." *See In re Stirling Homex Corp.*, 579 F.2d 206, 212 (2d Cir. 1978), *cert. denied*, 439 U.S. 1074 (1979).

24. This principle, as well as the right of creditors to receive post-petition interest when an estate is solvent, is embodied in provisions of the Bankruptcy Code. *See* Code sections 502, 726 and 1129, 11 U.S.C. §§ 502, 726 and 1129.

allowable. However, in that case the court expressly followed the rule petitioners say does not exist:

> [I]f the bankrupt is solvent and there is a surplus after payment of all claims, creditors should receive interest on their interest-bearing claims rather than having the surplus turned over to the debtor [*i.e.*, stockholders]. 4 B.R. at 798.[25]

There is no mystery as to why the "fair and equitable" rule requires payment of post-petition interest on *all* of the debentureholders' claims: CIC has detained millions of dollars of the debentureholders' funds during the five years this reorganization case was pending. Had CIC not elected to file a voluntary petition under the Bankruptcy Act the debentureholders could have obtained a judgment for the *entire* amount of their debt, including the accrued interest portion, and would have received interest from the date of entry of that judgment.[26] The filing of the petition prevented the entry of such a judgment. Where the estate is solvent, there is no reason to allow the debtor to use the reorganization case to shield itself from the obligation to pay interest *which it is fully able to pay*, and would have been required to pay but for the institution of those proceedings. In short, the First Circuit correctly recognized that there is no reason to allow a solvent debtor, such as CIC here, the free use for up to five years of $23 million of the debentureholders' money—the unpaid interest installments—where the debtor is fully able to pay for the use of that money.

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25. In determining whether to award post-petition interest the court followed federal bankruptcy law, not state law. Thus, secured creditors whose collateral was sufficient to cover post-petition interest received it; others did not because the estate was insolvent and, under *Vanston*, post-petition interest was not awardable because it would have reduced the recovery of junior creditors.

26. Where a judgment is obtained, "interest upon interest" is permitted under New York law. *See* note 34 *infra*.

B. The First Circuit's Application of the Fair and Equitable Rule Does Not Conflict With This Court's Decision in *Butner*.

Petitioners assert that there can be no federal bankruptcy rule permitting post-petition interest on claims for unpaid interest, because such a rule allegedly conflicts with this Court's decision in *Butner* v. *United States*, 440 U.S. 48 (1979) (Pet. at 20-21). Not so.

Butner holds that state real property law determines whether a mortgagee who has not foreclosed is entitled to receive the rents payable on the mortgaged property during a bankruptcy case. But in that case this Court repeatedly emphasized that state law must control only because Congress had not fashioned a federal rule defining a mortgagee's interest in rents, and that, had Congress done so, its rule would control:

> Property interests are created and defined by state law. *Unless some federal interest requires a different result*, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding (emphasis added). 440 U.S. at 55.

Butner does not conflict with the decision below because here, unlike in *Butner*, Congress *has* created a "federal rule" applicable to this case: the statutory "fair and equitable" rule for distributions to claimants under Chapter X, which requires the payment of post-petition interest on claims against a solvent estate. Because there *is* a Congressional mandate here, the First Circuit quite properly followed it.

C. Post-Petition Interest Was Properly Awarded on All Unpaid Installments of Interest.

Point II of the Petition asserts a "fall-back" position that, even if there is a bankruptcy rule requiring a solvent debtor to pay interest on *all* claims, that rule cannot apply to claims for interest which accrued after the filing of the petition. Making a series of technical arguments, petitioners would preclude the bankruptcy courts from awarding post-petition interest with respect to interest installments which accrued after a reorganization case was filed. None of these arguments has any merit; and none comes even close to raising an issue which might warrant the grant of certiorari.

First, petitioners assert that such an award cannot be made because the debentureholders' original proof of claim did not include a claim for installments of simple interest not owing at the time of the filing of the petition. This argument is incorrect because (a) the court of appeals did not construe the debentureholders' claims as being so limited (13a n.5, 16a); (b) the right to post-petition interest on a claim is a statutory right for which no separate proof of claim must be filed; and (c) in 1976, when the petition and the debentureholders' proofs of claim were filed, no one could have predicted whether the debtor would turn out to be solvent. Petitioners forget that the district court *did* award the debentureholders their post-petition simple interest installments; petitioners never objected on the ground that such post-petition installments could not be awarded because the debentureholders did not ask for them in their proof of claim.

Next, petitioners argue that any award of post-petition interest is barred by Section 63a of the Bankruptcy Act, 11 U.S.C. § 103, which prohibits the allowance of claims for unmatured interest. But Section 63 of the Bankruptcy Act is not applicable to a Chapter X case, as petitioners themselves concede (Pet. at 18 n.29). Under Section 106(1) of the Act, 11 U.S.C. § 506(1), the definition of a claim in Chapter X includes claims "not provable under Section 63."[27] Even the Trustee, in his brief (pp. 4-5) supporting the Petition herein, concedes that under Chapter X creditors are to receive interest *to the date of payment.*

Finally, petitioners claim that the First Circuit's award of post-petition interest on post-petition interest is not supported by any precedent. Petitioners have the argument backwards. The debentureholders' claim properly included all pre-petition and post-petition installments of simple interest; it therefore follows that there is no distinction between pre-petition and post-petition claims in determining whether post-petition interest on those claims should be allowed. In the absence of any contrary authority—and petitioners have cited none—the court of appeals made no error here.

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27. *See* note 23, *supra*. Definitions embodied in section 502(b) of the Bankruptcy Code also are not controlling here. *See* Bankruptcy Reform Act of 1978, § 403(a), *supra* note 5.

III.

THE ISSUES RAISED IN THE PETITION ARE MOOTED BY THE NEW BANKRUPTCY CODE.

Although the decision below was clearly correct under the Bankruptcy Act, even if there were some doubt on this score, certiorari would still not be warranted because the new Bankruptcy Code, which governs all bankruptcy cases commenced after September 30, 1979, unequivocally requires that solvent debtors pay post-petition interest on *all* claims. Thus, the question of whether the old Act also provides for such interest in the "dwindling number" of cases governed by the Act[28] will be of little consequence in the future, and is not the type of pressing issue which warrants examination by this Court.

Chapter 11 of the new Code governs reorganizations such as CIC's. Under section 1129(a)(7)(A)(ii) of chapter 11, a reorganization plan may be confirmed only if each creditor receives no less than he would have received in a chapter 7 liquidation. The relevant liquidation provision, section 726, entitled "distribution of property of the estate", sets forth rules of priority for distributions from the estate. The first four priorities include unsecured and secured claims. The fifth priority (superior to any right of the debtor to receive anything) is

> payment of interest at the legal rate from the date of the filing of the petition, on any claim paid. . . . Code section 726(a)(5).

Thus, where the estate has sufficient funds to pay such interest, Congress has *expressly required* the payment of

28. *See* the Trustee's brief in support of the Petition, pp. 2-3.

interest on *all* claims in chapter 7 (and therefore chapter 11) cases—*regardless* of whether there is any agreement providing for payment of such interest, and *regardless* of state law. As summarized in a recent commentary, under the Code

> If an estate is solvent, before the debtor is entitled to retain any property of the estate, creditors are required to receive post-petition interest in an amount computed at the "legal rate".[29]

Nor is there any doubt that under the Code the claims upon which post-petition interest *must* be allowed include claims for unpaid interest. Section 726 provides for payment of any "allowed unsecured claims";[30] and "claim" is defined by the Code (section 101(4)) to include *any* right to payment.[31] That this sweeping definition includes claims for interest is crystal clear from the legislative history:

> a right to payment for interest due is a right to payment which is within the definition of "claim" in section 101(4). . . .

Statement of the Legislative Leaders (House) 124 Cong. Rec. H 11,098 (daily ed. Sept. 28, 1978); (Senate) S 17,415 (daily ed. Oct. 6, 1978).[32]

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29. *Fortgang and King*, "The 1978 Bankruptcy Code: Some Wrong Policy Decisions", 56 N.Y.U.L. Rev. 1148, 1151 (1981). The Trustee, in his brief supporting the Petition, ignores this point while arguing that the Bankruptcy Code does not affect the issues raised in the Petition.

30. *See* section 726(a)(2).

31. Section 101(4)(A) defines "claim" to include

> right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, secured or unsecured . . . .

32. This is an excerpt from both the Senate and House reports on the final version of the Bankruptcy Code. It is quoted in Part 3, Collier *Bankruptcy Code* (1977 Pamphlet Ed. p. 341).

In short, the decision of the First Circuit in this case will be of very little relevance to the future administration of reorganization cases: it applies only to cases to be decided under the old Act, and it applies only where the debtor's estate is solvent—not an everyday occurrence by any means.[33]

IV.

THE DECISION OF THE COURT OF APPEALS WILL NOT AFFECT THE COMMERCIAL LAWS OF THE VARIOUS STATES.

We have demonstrated above that, under *Vanston*, state law does not control the determination of whether post-petition interest will be granted. In following this rule, the decision below will have no impact on the interaction between the laws of the states and the Bankruptcy Act. We also have demonstrated that the new Code on its face requires the payment of interest regardless of state law. Thus, petitioners' argument that the decision below will "render meaningless" state laws governing agreements for the payment of interest on interest, as well as state laws barring creditors with usurious contracts from collecting

33. In his brief in support of the Petition the Trustee laments that the court of appeals' decision has allegedly adversely affected stockholders in another case, *Continental Mortgage Investors*, No. 76-593-S (D. Mass.) (*"CMI"*), because the district court therein has construed the court of appeals' decision in this case to require post-petition interest to be computed at the legal rate, rather than the (lower) contractual rate. The fact that the decision below (purportedly) has been followed in one subsequent case is hardly startling. Nor is it surprising that application of the decision below would take money out of the hands of stockholders in order to fully compensate creditors. How that fact supports the granting of certiorari here is a mystery.

We express no view as to whether the district court in *CMI* correctly followed the First Circuit decision in this case. That question is not before this Court.

interest (Pet. at 25-26), is empty rhetoric. The decision here applies only in cases brought under the old Bankruptcy Act where the debtor turns out to be solvent. State law will surely survive such a microscopic "exception".[34]

But, petitioners argue, the opinion of the court below will invite creditors to commence cases under the Bankruptcy Code to improve their private contractual rights (Pet. at 26-29). This argument is a *non sequitur*, because the Code (which governs any reorganization case that might be filed now) expressly requires the universal payment of post-petition interest by solvent debtors, and will continue to do so, regardless of whether the decision below stands or falls. Moreover, this argument totally disregards the inherent delay attendant to bankruptcy and reorganization cases, and the Bankruptcy Code's protections to debtors against ill-founded involuntary petitions,[35] which

34. Under New York law interest on a judgment is allowed, as a matter of right, "upon the total sum awarded, including interest to verdict". N.Y. Civ. Prac. Law § 5002 (McKinney 1963 & Supp. 1964-81). Moreover, even pre-judgment interest on claims for interest may sometimes be awarded. *See, e.g., City of New York* v. *State of New York*, 95 Misc. 2d 810, 815-18, 408 N.Y.S. 2d 702, 704-07 (Ct. Cl. 1978) and cases cited therein.

35. *See* section 303 of the Bankruptcy Code, 11 U.S.C. § 303. Section 303(h) of the Code limits the basis for involuntary relief to (i) the debtor's general inability to pay debts as they become due, and (ii) the appointment of a "custodian" to take charge of substantially all of the debtor's property within 120 days preceding the petition. 11 U.S.C. § 303(h). Section 303(i) of the Bankruptcy Code gives the court the power to award costs, reasonable attorney's fees or "any damages proximately caused by the taking of possession of the debtor's property by a trustee" when an involuntary petition is dismissed after trial. Finally, under subsection (i)(2), if the court finds that a petition was filed in "bad faith" the court also may award the debtor "punitive damages" or "any damages proximately caused by such filing." 11 U.S.C. § 303(i)(2). Because a petitioning creditor is liable if a petition is ultimately dismissed, it is highly unlikely that a creditor would commence a case under the Bankruptcy Code merely to improve his contractual rights if the debtor is not otherwise eligible for relief.

together make it highly improbable that creditors would be tempted to try to misuse the bankruptcy courts to "improve" their rights. In fact, it is far more likely that if petitioners had their way and state law were to be controlling in the future, solvent debtors might voluntarily seek refuge in the bankruptcy courts to prevent their creditors from entering judgments against them which would then bear interest upon interest. Thereby debtors could obtain a "free ride", at their creditors' expense, for the duration of the case—which is exactly what petitioners are attempting to accomplish in this case.

In awarding debentureholders full compensation for the surrender of their claims, the First Circuit, rather than disrupting commercial law, actually was applying a fundamental principle of the commercial marketplace, which allocates the risk of investment in a failing company to stockholders rather than creditors. As expressed by the Second Circuit in *In re Stirling Homex Corp.*, 579 F.2d 206, 213-14 (2d Cir. 1978), *cert. denied*, 439 U.S. 1074 (1979):

> When persons or institutions lend money to a corporation, or otherwise become its creditors, they do so in reliance upon the protection and security provided by the money invested by the corporation's stockholders—the so-called "equity cushion". . . . Credit is given to corporations with little or no knowledge of names of stockholders, but with confidence that, whoever they are, their rights in and to corporate property are subordinate to the rights of creditors.[36]

36. *Accord, F.D.I.C.* v. *American Bank Trust Shares, Inc.*, 412 F. Supp. 302, 308 (D.S.C. 1976), *vacated on other grounds*, 558 F.2d 711 (4th Cir. 1977); *Scott* v. *DeWeese*, 181 U.S. 202 (1901); *Sanger* v. *Upton*, 91 U.S. [1 Otto] 56, 60 (1875); *Carter* v. *Bogden*, 13 F.2d 90, 93-94 (8th Cir. 1926); *Scott* v. *Abbott*, 160 F. 573 (8th Cir.), *cert. denied*, 212 U.S. 571 (1908).

In short, the court of appeals' narrow holding will neither impair the enforcement of state commercial law, nor increase the filing of involuntary petitions under the Bankruptcy Code.

CONCLUSION

For the reasons stated above, the petition for a writ of certiorari should be denied.

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